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this section exceeds the opening balance of such reserve (determined under such paragraph (b)(3)), and

(c) Finally, to the supplemental reserve for losses on loans

For purposes of determining the amounts of the credits under (a) and (b) of this subdivision, the opening balances of the reserve for losses on nonqualifying loans and the reserve for losses on qualifying real property loans shall be deemed to include the sum of the amounts of any prior credits made to such reserves pursuant to this subdivision.

(ii) If the recovery is in respect of a bad debt which is charged after December 31, 1962, against only one of the reserves established pursuant to paragraph (a) of this section, the entire amount recovered shall be credited to the reserve so charged.

(iii) If the recovery is in respect of a bad debt which is charged after December 31, 1962, against more than one of the reserves established pursuant to paragraph (a) of this section, then the amount recovered shall be credited to each of the reserves so charged in the ratio which the amount of the bad debt charged against such reserve bears to the total amount of such bad debt charged against both such reserves.

(iv) Subdivision (i) of this subparagraph may be illustrated by the following example:

Example. In 1962, the taxpayer sustained a bad debt of \$10,000, which was charged against a reserve for bad debts established pursuant to section 166(c). As of the close of December 31, 1962, the balance of the taxpayer's reserve for losses on nonqualifying loans was \$2,000, the amount determined under paragraph (b)(2)(ii) of this section. As of the same time, the balance of the taxpayer's reserve for losses on qualifying real property loans was \$100,000, but the amount determined under paragraph (b)(3)(ii) of this section was \$106,000. In 1963, the taxpayer recovers \$8,000 of the \$10,000 charged off in 1962. Of the \$8,000 recovered in 1963, \$6,000 (\$106,000 minus \$100,000) is credited to the reserve for losses on qualifying real property loans, and the balance of \$2,000 is credited to the supplemental reserve for losses on loans.

[T.D. 6728, 29 FR 5859, May 5, 1964, as amended by T.D. 549, 43 FR 21457, May 18, 1978]

§ 1.593-8 Allocation of pre-1952 surplus to opening balance of reserve for losses on qualifying real property loans.

(a) *General rule.* In the case of a taxpayer described in § 1.593-4, if the amount of pre-1963 reserves allocated (under paragraph (b)(3)(i) of § 1.593-7) to the opening balance of the reserve for losses on qualifying real property loans is less than an amount equal to the greater of:

(1) The total amount of qualifying real property loans outstanding at the close of December 31, 1962, multiplied by 3 percent, or

(2) The amount which would constitute a reasonable addition to the reserve for losses on such loans under § 1.166-4 for a period in which the amount of such loans increased from zero to the amount thereof outstanding at the close of December 31, 1962

then such opening balance shall be increased by an amount equal to so much of the *pre-1952 surplus* of the taxpayer as is necessary to increase such opening balance to the greater of the amounts described in subparagraph (1) or (2) of this paragraph. The amount of such increase shall be deemed to be included in such opening balance solely for the limited purpose described in paragraph (d) of this section.

(b) *Pre-1952 surplus defined*—(1) *In general.* For purposes of this section and § 1.593-7, the term *pre-1952 surplus* means an amount equal to:

(i) The sum of the taxpayer's surplus, undivided profits, and reserves determined (under the principles of paragraph (d)(2) of § 1.593-1) as of the close of the taxpayer's last taxable year beginning before January 1, 1952 (including any amount acquired from another taxpayer), minus

(ii) The amount of any impairments of such sum (as determined under paragraph (c) of this section).

(2) *Reduction for certain excludable interest.* (i) The amount otherwise determined under subparagraph (1) of this paragraph may, at the option of the taxpayer, be reduced by the portion, if any, of such amount which is attributable to interest which would have been excludable from gross income of such taxpayer under section 22(b)(4) of

the Internal Revenue Code of 1939 (relating to interest on governmental obligations) or the corresponding provisions of prior revenue laws, had such taxpayer been subject, when such interest was received or accrued, to the income tax imposed by such Code or prior revenue laws.

(ii) For purposes of subdivision (i) of this subparagraph, the portion of the amount otherwise determined under subparagraph (1) of this paragraph which is attributable to interest which would have been excludable from gross income shall be determined by multiplying such amount by the ratio which:

(a) The total amount of such excludable interest for the period before the taxpayer's first taxable year beginning after December 31, 1951, bears to

(b) The total amount of the taxpayer's gross income, plus the total amount of such excludable interest, for such period

If the amount determined under subparagraph (1)(i) of this paragraph includes any amount acquired from another taxpayer, then the gross income and excludable interest of the taxpayer for the period before its first taxable year beginning after December 31, 1951, shall include the gross income and excludable interest (for the same period) of such other taxpayer.

(c) *Impairment of surplus, undivided profits, and reserves*—(1) *General rule.* In the case of a taxable year beginning after December 31, 1951, and ending before January 1, 1963, if for such year:

(i) The amount described in paragraph (b)(1)(i) of this section (as decreased under subparagraph (3)(i) of this paragraph), exceeds

(ii) The sum of the taxpayer's surplus, undivided profits, and reserves (excluding the amount of any pre-1963 reserves) determined as of the close of such year under the principles of paragraph (d)(2) of § 1.593-1

then the amount described in paragraph (b)(1)(i) of this section may, at the option of the taxpayer, be reduced by the amount of such excess.

(2) *Transition year.* In the case of a taxable year beginning before January 1, 1963, and ending after December 31, 1962, the part of such year which occurs before January 1, 1963, shall be consid-

ered to be a taxable year for purposes of subparagraph (1) of this paragraph.

(3) *Rules for applying subparagraph (1).*

(i) For purposes of subparagraph (1)(i) of this paragraph, the amount described in paragraph (b)(1)(i) of this section shall be decreased by the total of any reductions under subparagraph (1) of this paragraph for prior taxable years; and

(ii) For purposes of subparagraph (1)(ii) of this paragraph, the term *pre-1963 reserves* means the amount determined under the principles of paragraph (b)(1) of § 1.593-7 for the period which begins with the first day of the first taxable year beginning after December 31, 1951, and which ends at the close of the taxable year with respect to which the computation under subparagraph (1) is being made.

(d) *Treatment of pre-1952 surplus.* Any portion of the taxpayer's pre-1952 surplus which, pursuant to paragraph (a) of this section, is deemed to be included in the opening balance of the reserve for losses on qualifying real property loans shall not be treated as a reserve for bad debts for any purpose other than computing for any taxable year the amount determined under the method described in paragraph (b), (c), or (d) of § 1.593-6 (relating, respectively, to the percentage of taxable income method, the percentage of real property loans method, and the experience method) or paragraph (b), (c), or (d) of § 1.593-6A (relating, respectively, to the percentage of taxable income method, the percentage method, and the experience method). For such limited purpose, such portion shall be deemed to remain in, and constitute a part of, the reserve for losses on qualifying real property loans. For all other purposes, such portion will retain its character as part of the taxpayer's pre-1952 surplus.

(e) *Example.* The provisions of this section may be illustrated by the following example:

Example. (1) *Facts.* X Corporation, a mutual savings bank organized in 1934, makes its returns on the basis of the calendar year and the reserve method of accounting for bad debts. For the taxable years 1934 through 1951, X's gross income was \$2.7 million, in addition to which X received \$300,000 of interest which would have been excludable from gross income under section 22(b)(4) of the Internal

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Revenue Code of 1939, or the corresponding provisions of prior revenue laws, if X had been subject to the income tax imposed by such Code or prior revenue laws when such interest was received. At the close of 1951, the sum of X's surplus, undivided profits, and reserves was \$650,000. At the close of 1954, X had pre-1963 reserves of \$10,000, and surplus, undivided profits, and reserves of \$630,000. At the close of 1955, X had pre-1963 reserves of \$15,000, and surplus, undivided profits, and reserves of \$625,000. At the close of 1962, X had pre-1963 reserves of \$55,000, nonqualifying loans of \$4 million, and qualifying real property loans of \$10 million. It is assumed that, under § 1.166-4, \$16,000 would constitute a reasonable addition to the reserve for losses on nonqualifying loans for a period in which such loans increased from zero to \$4 million and \$20,000 would constitute a reasonable addition to the reserve for losses on qualifying real property loans for a period in which such loans increased from zero to \$10 million.

(2) *Impairment of surplus, undivided profits, and reserves for 1954.* The sum of X's surplus, undivided profits, and reserves at the close of 1951 was impaired during 1954 by \$30,000, computed as follows:

Sum of surplus, undivided profits, and reserves at close of 1951	\$650,000
Less:	
Sum of surplus, undivided profits, and reserves at close of 1954, excluding pre-1963 reserves at close of such year (\$630,000 minus \$10,000)	620,000
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	30,000

(3) *Impairment of surplus, undivided profits, and reserves for 1955.* The sum of X's surplus, undivided profits, and reserves at the close of 1951 was further impaired during 1955 by \$10,000, computed as follows:

Sum of surplus, undivided profits, and reserves at close of 1951, decreased by amount of 1954 impairment (\$650,000 minus \$30,000) ...	\$620,000
Less:	
Sum of surplus, undivided profits, and reserves at close of 1955, excluding pre-1963 reserves at close of such year (\$625,000 minus \$15,000)	610,000
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	10,000

(4) *Pre-1952 surplus.* X's pre-1952 surplus is \$549,000, computed as follows:

Sum of surplus, undivided profits and reserves at close of 1951 ...	\$650,000
Less:	
Sum of impairments for 1954 and 1955 (\$30,000 plus \$10,000)	40,000
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	\$610,000

Less:

Portion of such \$610,000 which is attributable to excludable interest (\$610,000 multiplied by \$300,000/\$3 million)	61,000
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	549,000

(5) *Allocation of pre-1963 reserves to reserve for losses on nonqualifying loans and to reserve for losses on qualifying real property loans.* Of the \$55,000 of pre-1963 reserves at the close of 1962, \$16,000 (the amount which would constitute a reasonable addition to the reserve for losses on nonqualifying loans for a period in which such loans increased from zero to \$4 million) shall be allocated to, and constitute the opening balance of, the reserve for losses on nonqualifying loans, and the balance of \$39,000 (\$55,000 minus \$16,000) shall be allocated to, and constitute a part of the opening balance of, the reserve for losses on qualifying real property loans.

(6) *Allocation of pre-1952 surplus to reserve for losses on qualifying real property loans.* X's pre-1963 reserves are not sufficient to bring the opening balance of the reserve for losses on qualifying real property loans to \$300,000, which is an amount equal to the greater of:

- (i) \$300,000 (i.e., \$10 million of qualifying real property loans outstanding at the close of 1962, multiplied by 3 percent), or
- (ii) \$20,000 (the amount which would constitute a reasonable addition to the reserve for losses on such loans under § 1.166-4 for a period in which the amount of such loans increased from zero to the \$10 million).

Therefore, \$261,000 (\$300,000 minus \$39,000) of X's pre-1952 surplus of \$549,000 shall be deemed to be included in the opening balance of such reserve in order to increase such opening balance to \$300,000.

[T.D. 6728, 29 FR 5861, May 5, 1964, as amended by T.D. 549, 43 FR 21457, May 18, 1978]

§ 1.593-10 Certain distributions to shareholders by a domestic building and loan association.

(a) *In general.* Section 593(f) provides that if a domestic building and loan association (as defined in section 7701(a)(19) and the regulations thereunder) distributes property after December 31, 1962, to a shareholder with respect to its stock and if the amount of such distribution is not allowable to the association as a deduction under section 591 (relating to deduction for dividends paid on deposits), then, notwithstanding any other provision of the Code, the distribution shall be treated as provided in paragraphs (b) and (c) of this section. For purposes of